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UNIDO ACTIVITIES IN THE FIELD OF RESTRUCTURING, INCLUDING PRIVATIZATION

Report by the Director-General

Summary

Reviews recent trends in restructuring and privatization and provides information on UNIDO activities, ongoing as well as planned, in that area.

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Introduction

1. The present document on restructuring, including privatization, is submitted at the request of the Government of India. The growing importance of this aspect of economic development has been highlighted in United Nations General Assembly resolutions 45/188 and 46/166 on entrepreneurship and 47/171 on privatization in the context of economic restructuring. The role of the private sector in industrial development has been briefly touched upon by the Special Advisory Group to the Director-General of UNIDO on specific activities of the Organization (GC.3/25, para. 21; GC.4/22, para. 8; GC.4/23, para. 6).

I. RESTRUCTURING AND PRIVATIZATION

2. In the aftermath of independence, a majority of developing countries aimed first and foremost at meeting the basic needs of their population, such as food, clothing, housing, education and health. Faced with balance-of-payments liabilities and foreign exchange shortages, they essentially turned to import-substitution strategies and focused on a limited range of industrial production areas.

3. In the absence of a dynamic industrial entrepreneurship, and failing altogether to set up a business environment conducive to its emergence, most Governments intervened massively in the production sphere to the extent of acting as the largest investors and managers, with often poor results to be observed two or three decades later. Thus, the public sector assumed the twin functions of an industrial investor, on the one hand, and of the regulator establishing and enforcing the rules for industrial development, on the other.

4. The last decade saw the implementation, in most developing countries, of far-reaching reforms at the economic, political and social levels geared towards significant liberalization. From the economic point of view, the efforts made towards increased openness and transparency triggered a radical adjustment process of domestic structural patterns with often dramatic effects on a country's industrialization endeavours. The cornerstone of these reform programmes has been to achieve a transparent price system that reveals

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the economic value of goods and services. This entails, among other factors, less entry barriers and price controls, more realistic exchange and interest rates.

5. Concomitantly, there has been a powerful trend on the global scene and in the various developing regions for the private sector in general and private industrial enterprises in particular to assume a growing, and indeed leading, role in economic and industrial restructuring efforts. Many Governments - disenchanted with the limited growth dynamics generated by public sector-led industrial development - have turned to stimulating private initiative through far-reaching deregulation and privatization programmes. In industrial restructuring programmes, increased reliance has been placed on market forces within an environment of stronger competition in final product markets, input markets and financial markets. As part of this overall process, import protection has generally declined and many restrictions on foreign direct investment have been lifted.

6. Those trends are reflected in above-average growth rates for private investment in most developing countries. In the second half of the 1980s, the rebound of private investment was stronger than the recovery of gross domestic investment, implying a shift within total investment in favour of private sector capital formation.

7. At the same time, the increased role of the private sector in industrial development does not imply that government policy is becoming redundant or that it is becoming less important than in the past. On the contrary, a strong and efficient Government capable of designing, implementing and enforcing a consistent set of industrial policies is a sine qua non if the private sector is to prosper in a stable framework. Reliance on markets, competition and private initiative is not to be equated with a "laissez-faire" economy, and Governments will continue to play an important, though different, role.

8. In addition to creating the required infrastructure and a stable macroeconomic framework through appropriate monetary and fiscal policies, Governments can make important contributions to industrial restructuring by stimulating technological innovation and enhancing industrial efficiency and competitiveness. Indeed, international competitiveness is no longer just a micro-level phenomenon; today it is as much determined at the sectoral and national levels as it is at the company level.

9. Prominent among the instruments usually deployed to foster an effective industrial restructuring process is privatization. In general terms, privatization is understood as the transfer of ownership and control of an enterprise or activity from the public to the private sector. Privatization thus comprises the outright or partial sale (including corporatization) of state holdings to private sector interests as well as the contracting out or granting of operating concessions to private business including management, leasing and franchising arrangements. Moreover, the charging of market prices instead of fees for publicly supplied goods and services in a broader sense is sometimes being referred to as financial privatization.

10. Thus, privatization includes not merely divestment, but a whole range of modalities for transferring the production of goods and services from the public to the private sector, as well as the policy and institutional actions and framework needed to implement a programme of such transfers, and future reliance on private industry. Where privatization is merely the transfer of one or a small group of enterprises to the private sector, and where the legislation and policies are in place, privatization is a technical task that can be handled by accountants, merchant bankers and attorneys specializing in corporate law.

11. However, for many countries privatization is an immensely more complex task. Such countries have public sectors that are large, important parts of their economies, and where privatization carries huge risks: financially, economically, socially, culturally and politically. For those countries, privatization is difficult and requires skills and experience that are in short supply within the country. In countries with large public sectors, a privatization programme will often require external support in the broad areas of policy and strategy, institutional and enterprise level.

II. PAST AND CURRENT UNIDO ACTIVITIES

12. Restructuring has been one of the areas of UNIDO technical cooperation activities for the last two decades and relevant experience has been accumulated. Privatization, however, has been included in the UNIDO programme and budgets only since the biennum 1990-1991, after the subject started to gain importance in the late 1980s, particularly following the dismantling of the centrally planned economies in Central and Eastern Europe and the concomitant political and economic changes world-wide.

13. Preparation for a programme on privatization began in November 1989, when a framework for privatization was prepared and submitted for consideration by representatives from 20 developing countries at a workshop held in Vienna. As a result of the workshop, it was decided to initiate a full-scale privatization programme within UNIDO. Strategies on privatization were elaborated within the Institutional Infrastructure Branch and technical cooperation activities commenced in 1990. Over the past three years UNIDO has undertaken a number of activities including organizing and conducting workshops, undertaking diagnostic missions, and backstopping technical cooperation projects in privatization. A first report on activities for the development of the private sector was included in the Annual Report of UNIDO, 1991 (ID8.9/10, chap. IV, paras. 48-56).

14. The UNIDO approach is to maintain a comprehensive and integrated modular capability for industrial restructuring and privatization, to respond to the specific needs of each country. In other words, UNIDO can provide specific assistance, if required, but can also backstop large multidisciplinary projects. As a multidisciplinary process, privatization involves many different functions and activities. UNIDO is in a good position to provide such complex assistance in privatization, given the Organization's wide range of industrial activities. Above all, UNIDO seeks to place the privatization issue in the broader

context of private sector development in which privatization per se is just one of many dimensions involved. It is important to recognize the complementarity of: (a) privatizing existing industries and (b) promoting new private industrial investment at the same time. A brief review of the increasing role of the private sector in industrial development in Asian developing countries and the implications for UNIDO's role has been recently issued (Regional and Country Studies Branch, PPD.238(SPEC.)).

15. At the policy and strategy level, UNIDO provides assistance to develop policies that will guide privatization in the context of national industrial restructuring. In line with the world-wide trend towards market economies and increased liberalization, alternative development scenarios have been mapped out to fully exploit the countries' existing and potential comparative advantages and adjust manufacturing patterns towards an efficient insertion into the global market. These scenarios will determine the types of privatization to be pursued, the role of foreign investors, the criteria for selecting enterprises to be privatized, and conditions of sale. Appropriate legislation is an important component at this level. Based on known government policies and objectives, UNIDO can assist in preparing a privatization strategy and work plan. In fact, many technical cooperation activities related to strategies and policies have concentrated on the industrial restructuring process (IDB.11/10, chap. V, paras. 75, 79). The Governments of such diverse countries as Albania, Bhutan, Cyprus, Malaysia and Papua New Guinea, to name but a few, were assisted in formulating industrial strategies and policies.

16. Further policy-level activities of UNIDO related to privatization include assistance in the formulation of a privatization strategy in Poland (IDB.11/10, chap. V, para. 104), as well as proposals for large-scale technical cooperation projects in Angola and Ethiopia. Assistance at all levels, but particularly at the policy and strategy levels, comes from workshops that UNIDO organizes and/or participates in, such as a workshop recently organized and conducted to review the results of economic policies in Eastern Europe and the Commonwealth of Independent States countries; a number of workshops conducted by UNIDO in privatization-related activities including the workshop on technical cooperation for privatization held at Istanbul, Turkey (November 1992), co-sponsored workshops on privatization in Russia, convened in Moscow, Russian Federation (with the Russian Fund for Federal Property), the seminar on industrial restructuring in East European countries (Vienna, October 1992) and the workshop on privatization at Tashkent, Uzbekistan. At the Tashkent workshop held in February 1993, representatives from the International Labour Organisation, the United Nations Department of Economic and Social Development and the United Nations Development Programme (UNDP) were invited by UNIDO to help initiate the United Nations programme in Uzbekistan. Finally, in June 1993, UNIDO is organizing a workshop on privatization for African least developed countries.

17. At the institutional level, Governments require the ability to design, initiate and supervise privatization of enterprises, and to carry out other activities that support the process. This calls for government staff with the skills required to undertake those activities and for assistance to develop the organizational structure, specific policies and procedures as well as supporting legal documents, guidelines, checklists and manuals.

18. UNIDO assistance at the institutional level emphasizes the training of government staff to undertake those functions, the reform of the administrative machinery of government and the provision of external advisers for specialized areas. Through its Institutional Infrastructure Branch, UNIDO has provided such assistance, in cooperation occasionally with the Industrial Management and Rehabilitation Branch, as in Albania, Angola, Egypt, Ethiopia and Poland.

19. In Albania, missions carried out in 1991 and 1992 by UNIDO staff and consultants reviewed the institutional setting for privatization, and made recommendations on the organizational structure for privatization, including a plan for training assistance, which was submitted by UNDP to the Donors' Group meeting for Albania. A project aimed at strengthening the capabilities of the ministries dealing with enterprises in Albania as well as the valuation and restructuring of the largest state-owned enterprises was formulated during one of these missions; several of its recommendations have already been implemented by the authorities and the project is now planned for funding by UNDP.

20. Another example is a workshop held at Istanbul, Turkey (see para. 16 above), the purpose of which was to identify the needs for assistance of 10 countries. As a result of that workshop, training activities in Peru and Uzbekistan were planned and implemented, and programmes in several other countries are now being developed. The recommended creation of regional networks, at which the privatization agencies of countries could exchange experience and undertake projects of common interest, was a result of the workshop, and this possibility is now being explored.

21. At the enterprise level, Governments need support in the mechanics of individual privatization cases. Techno-economic assessments of the potential viability of enterprises, training of enterprise directors and managers, preparation of valuations, audits and restructuring plans are all important aspects of privatization at this level. UNIDO can assist in the execution of most of these activities.

22. In a project that provides advisory support to the Ministry of Industry, Trade, Tourism and Integration in Peru, for example, UNIDO provided experts in chemicals and pulp and paper, in order to establish the technical basis necessary to make informed decisions regarding the proper modality of privatization in that field. In Poland, a large project is under way to restructure 15 of the largest state-owned enterprises to enable them to adapt to the new economic environment and to make them suitable for privatization. In Guyana, UNIDO assisted the Government in the restructuring and privatization of several state-owned enterprises. The experience gained at the individual enterprise level provides valuable feedback for policy and strategy formulation.

23. These are only a few examples of the various activities undertaken by UNIDO with regard to industrial restructuring and privatization. Other UNIDO work related to privatization includes

investment promotion forums that play a role in providing foreign capital imports for successful privatization; and entrepreneurship development and small- and medium-scale industry programmes that are instrumental in strengthening the domestic basis for industrial restructuring and in offering additional employment potential for workers laid off as a result of privatization.

III. ACTIVITIES FOR THE 1994-1995 BIENNIUM

24. At present, a number of proposals for large-scale technical cooperation projects have been or are being developed, which will call upon various units within UNIDO for implementation, e.g. in Ecuador, Ethiopia, Guyana, Peru, Sudan and Uzbekistan.

25. However, future activities related to privatization in the context of national industrial development strategies include more than technical backstopping of projects. UNIDO can, with adequate resources, play a key role in the development of privatization practices in developing countries, with emphasis on industrial restructuring. To that end, it is proposed that UNIDO undertake research in privatization-related areas, conduct expert group meetings to advance the state-of-the-art in privatization, organize and conduct additional workshops, and form networks on privatization, to disseminate information and knowledge of privatization throughout the world, and help coordinate various aspects of privatization among multilateral and bilateral institutions.

26. In further strengthening its privatization-related technical cooperation activities, UNIDO will ensure that its special expertise effectively complements the programmes carried out by other international organizations. This implies a clear focus on the linkages between privatization and industrial restructuring in terms of overall pre-conditions for successful privatization, as well as the impact of privatization on industrial performance.

27. The support expected from UNIDO in the field of privatization obviously varies from country to country. The type of activities will be particularly dependent on the recipient country's level of economic development and the stage of its privatization programme.

28. UNIDO could offer useful services in privatization at the enterprise level to all developing countries. This would include advice on specific enterprise privatizations and on preparation of business plans. For example, enterprise-level work may combine the services of a privatization adviser, specialists in the specific industry or sector, and a restructuring specialist. Thus, for the privatization of individual industrial enterprises, UNIDO could offer the services of different specialists. With its comparative advantage of multidisciplinary capability, UNIDO can also advise on alternative modalities for privatization and their operationalization. This may include, for example, the break-up of large enterprises into smaller, potentially-viable units for the purpose of privatization.

29. In some countries, especially those where skills are in short supply, UNIDO has the capability to offer a much broader array of services. In such countries, privatization is a particularly difficult process because it requires specialized assistance in many different functional areas. For those countries, there is a need for an unbiased organization to provide comprehensive technical support to the privatization process. That support should include policy, institutional, and enterprise-level activities. In Ethiopia or Uzbekistan, for example, the programmes are in the early stages of development, and the staff lacks sufficient exposure to market economics. UNIDO can provide the technical support from in-house sources, while at the same time helping to recruit and evaluate outside consultants, until such time as training programmes equip local personnel to perform those tasks. In such programmes, UNIDO can act as the primary adviser to the Government on privatization, bringing in specialized expertise as needed.

30. In short, while UNIDO intends to develop more fully its services for privatization of specific enterprises, industries or sectors, it also intends to develop its capabilities to backstop assistance to the privatization process in general, and not merely to individual privatization cases.

IV. ACTION REQUIRED OF THE BOARD

31. The Board may wish to take note of the present report and provide further guidance.